

DIRECT TESTIMONY OF

JIMMY E. ADDISON

ON BEHALF OF

SOUTH CAROLINA ELECTRIC & GAS COMPANY

DOCKET NO. 2004-178-E

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND POSITION.

A. My name is Jimmy E. Addison and my office is located at 1426 Main Street, Columbia, South Carolina. I am Vice President, Finance of South Carolina Electric & Gas Company (“SCE&G”) and hold a similar position at SCANA Corporation, which is the parent company of SCE&G.

Q. PLEASE DESCRIBE YOUR EDUCATION AND BUSINESS BACKGROUND.

A. I am a graduate of the University of South Carolina with a Bachelor of Science Degree in Business Administration, majoring in accounting, and a Master of Accountancy Degree. Also, I hold a certificate as a Certified Public Accountant in South Carolina. Prior to my employment by the Company in March 1991, I was employed for seven years by the certified public accounting firm of Deloitte & Touche, where I was designated an Audit Manager as a public utility accounting and audit specialist. I was also a partner in the public

1 accounting firm of Hughes, Boan and Addison immediately prior to joining the
2 Company. I currently serve as treasurer of the Southeastern Electric Exchange.

3 **Q. WHAT ARE YOUR DUTIES WITH SCE&G?**

4 **A.** As Vice President, Finance of SCE&G I have responsibility for
5 planning, directing and overseeing the finance, accounting, treasury, investor
6 relations, sourcing and information technology functions.

7 **Q. HAVE YOU EVER TESTIFIED BEFORE THIS COMMISSION?**

8 **A.** Yes. I have testified in several proceedings before this Commission
9 including the 1992 and 1995 electric rate cases.

10 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

11 **A.** There are three principal purposes of my testimony.

- 12 • First, I review the magnitude of the capital expenditures that SCE&G
13 has been required to make in its generating plants since 1992.
- 14 • Second, I discuss material non-capital related drivers of the rate
15 request and certain actions taken by the Company to mitigate increased
16 costs.
- 17 • Third, I discuss the Saluda Dam Remediation Project (the
18 “Remediation Project” or the “Project”) and the Company’s proposal
19 to use certain Synthetic Fuel Tax Credits, as well as the other tax
20 benefits from the Project, to offset the capital costs that the Company

would otherwise have sought to collect from customers.

Q. AS A MATTER OF INTRODUCTION, PLEASE EXPLAIN THE DYNAMICS OF RELATING INTERNAL FINANCIAL DATA TO A RATE RELIEF REQUEST.

A. Requests for rate relief are based on financial data indicating that operations in the test year ended March 31, 2004 did not produce adequate revenue for the company to meet its expenses including the cost of capital. The variables that go into this calculation include all components of expense and revenue related to the Company's electric operations. These components change over time and all are netted together in measuring financial results. As a result, the change in any single component or group of components cannot be viewed in isolation because those components interact with or are offset by many other components that are also changing over time.

Q. PLEASE GIVE EXAMPLES OF THIS OFFSETTING OR INTERACTION AMONG COMPONENTS.

A. Certainly. One example would be that service to additional customers may result in additional revenues, but additional expenses (more personnel, billing costs, investments in lines and plants) are involved in providing the service. In measuring financial performance, the increase in revenues and the increase in expenses are netted against each other. In the same way, investments in new technology may increase productivity (reducing labor

costs per customer served over time), but there are associated capital costs, depreciation expenses, property taxes and maintenance costs. These are conceptual examples only. The point is that there are many interrelated and offsetting components that influence the need for rate relief.

Q. WITH THOSE LIMITATIONS IN MIND, WHAT SORT OF ANALYSIS OF THE COMPONENTS UNDERLYING A RATE INCREASE WOULD BE APPROPRIATE?

A. Although a precise reconciliation of components is not possible, it is possible to identify major items of revenue or expense that are changing in material ways. It is also possible to discuss how and why these components are changing, and to consider the directional impact they have on the Company's need for additional revenue to maintain an acceptable level of earnings.

Q. IN THE PRESENT CASE, WHAT ARE THE COMPONENTS YOU SEE AS IMPORTANT FOR THIS SORT OF ANALYSIS?

A. The most important single component underlying this case is the Company's increased levels of investment in generation assets and the related capital cost, depreciation and O&M expense associated with that level of investment. In addition, the Company's property tax bill has risen substantially in recent years due to increasing financial pressures on local governments. Offsetting these increases in part has been a reduction in the

1 Company's cost of debt, due largely to the Company's aggressive refinancing
2 program. In addition, the Company is requesting a return on equity in this
3 case that is substantially lower than that on which current rates have been set.
4 Other expense and revenue items have gone up or down with inflation, and
5 with customer and demand growth on the system. But the individual factors
6 listed above are what I believe to be the most material individual factors that
7 can be identified in the context of the present rate request.
8

9 **CAPITAL INVESTMENT IN GENERATION**

10
11 **Q. WHAT ROLE DOES CAPITAL INVESTMENT IN GENERATION**
12 **PLAY IN THE PRESENT RATE REQUEST?**

13 **A.** In recent years, the Company has invested substantial additional
14 capital in its generation system. Other witnesses will testify concerning the
15 addition of the remaining investment in the Jasper Generating Station into
16 rates. While Jasper represents an important addition to rate base, it is by no
17 means the only investment that the Company has been making in generation
18 related assets. In fact, if you look at the history of the Company's investment
19 in generation assets over the past 12 years, you will see that investment in
20 new generation has been matched by a similar level of investment in capital
21 maintenance/refurbishment of existing plants and of investment in new

1 pollution control technology.

2 **Q. WHY DO YOU LOOK AT SCE&G'S GENERATION INVESTMENT**
3 **OVER A 12 YEAR PERIOD?**

4 **A.** There are two reasons why 1992-2003 is an appropriate period for
5 reviewing SCE&G's generation related investments. First, in 1992 the
6 Company had recently begun construction of the Cope Generating Station.
7 Cope Station was the Company's first new base load plant since V.C.
8 Summer was placed into commercial operation in 1984. In other words, 1992
9 was at the beginning of the construction cycle that saw the Company build
10 Cope, repower and expand Urquhart, and now complete Jasper.

11 In addition, going back to 1992 captures the investments that the
12 Company has been required to make in response to the Clean Air Act
13 Amendments of 1990. As discussed below, environmental related investment
14 has been quite significant over this period.

15 **Q: PLEASE REVIEW THE COMPANY'S INVESTMENTS IN**
16 **ENVIRONMENTAL COMPLIANCE PROJECTS SINCE 1992.**

17 **A.** Since 1992, the Company has been required to retrofit plants or
18 otherwise invest in technology to reduce emissions of sulfur oxides ("SOx"),
19 nitrogen oxides ("NOx"), and particulates. State and Federal regulations
20 concerning water quality also play a role in some projects.

1 The list of the generation-related environmental projects since 1992
2 includes:

- 3 • Installing systems to monitor plant emissions;
- 4 • Installing low NOx burners and Selective Catalytic Reactor Systems
5 (“SCR’s”) to reduce nitrogen oxide pollution;
- 6 • Adding bag houses to remove particulate matter from the exhaust gas
7 stream;
- 8 • Building closed cycle cooling towers to reduce thermal discharge to
9 rivers; and
- 10 • Installing liners in ash ponds and constructing new ash landfills to
11 reduce discharges to ground and surface water.

12 The collective cost of these projects over the period 1992-2003 was
13 \$395 million, or roughly the value of the Company’s investment in the Cope
14 Station. (This \$395 million figure does not, by the way, include the \$287
15 million expected cost of the Saluda Dam Remediation Project, which is
16 discussed separately below.) As Company witness Mr. Lorick has testified,
17 investments in these environmental improvements are not optional, but are
18 required by law if the Company is to continue using the plants in question to
19 serve customers.

1 The present rate request reflects the investment made by the Company
2 in these environmental upgrades since the last rate proceeding. Expenditures
3 for similar environmental upgrades are continuing at a substantial level, and
4 additional significant environmental projects are planned in the coming years.

5 **Q. PLEASE DISCUSS THE COMPANY’S RECENT INVESTMENT IN**
6 **CAPITAL MAINTENANCE AND REFURBISHMENT PROJECTS AT**
7 **EXISTING GENERATING STATIONS?**

8 **A.** The Company also spends substantial funds in capital maintenance and
9 refurbishing of existing generation facilities. Generation plants are built to
10 last for decades. However, as these plants are used to serve customers, they
11 must be renovated and upgraded from time to time.

12 During the period 1992 to 2003, in addition to its environmental
13 expenditures, the Company spent \$578 million in capital maintenance,
14 upgrades and refurbishments to its existing generation plants. This represents
15 necessary investment in the continued value of these plants to the system.
16 However, these investments provided very limited additional capacity.

17 All told, during the 1992 to 2003 period, SCE&G spent slightly less
18 than a billion dollars, \$973 million to be exact, on environmental and capital
19 maintenance/refurbishment projects for its generation units. This cost was
20 incurred on necessary projects, but it was not associated with service to
21 additional customers or additional sources of revenue. To put these

1 expenditures in perspective, the amount spent during this period on non-
2 capacity expanding capital projects was \$300 million in excess of the amount
3 spent on new capacity which included completion of the new coal fired base
4 load plant at Cope (410 MW), the Urquhart Repowering Project (330 MW net
5 increase) and various projects to increase the output of other facilities (147
6 MW net increase).

7 **Q. WHAT EFFECT DOES THIS INVESTMENT HAVE ON SCE&G'S**
8 **REVENUE REQUIREMENTS?**

9 **A.** This \$973 million investment has had a direct impact on the
10 Company's rate base, and additional revenues have been required to support
11 this incremental investment. But in addition to these direct capital costs,
12 these investments also have increased expenses related to depreciation,
13 property taxes and property insurance. All these expenses are directly related
14 to the value of the Company's investment in utility plant.

15 **Q. PLEASE DISCUSS THE COMPANY'S RECENT INVESTMENT IN**
16 **NEW GENERATION CAPACITY.**

17 **A.** Mr. Lorick has discussed in his testimony the growth of load on our
18 system and the most recent investments made to support that growing load.
19 During the period 1992 to 2003, SCE&G placed in service capacity addition
20 projects with a capital value of \$672 million. This amount includes the cost

1 of the Cope Plant, the Urquhart Repowering Project, and the capacity
2 additions at various other plants.

3 The \$672 million figure does not, however, include the cost of the
4 Jasper Plant, which was placed in service in 2004. The Company's total
5 investment in the Jasper Generation Project is \$506,039,714. Of that amount,
6 the Commission allowed \$276,224,951 to be reflected in rates in Order No.
7 2003-38 as Construction Work in Progress or CWIP. The remaining capital
8 cost of the project totals \$229,814,763 and is being reflected in rates for the first
9 time in this proceeding.

10 **Q. IS THE GENERATION SYSTEM THE ONLY AREA WHERE THE**
11 **COMPANY INCURS SIGNIFICANT CAPITAL COSTS?**

12 **A.** Not at all. The Company also invests significant capital from year to
13 year in its distribution and transmission system, in upgraded system control
14 facilities, in computer systems, in vehicles, in buildings and in technology.
15 However, capital investments in these categories usually involve much smaller
16 expenditures relative to total rate base. These investments are often mitigated
17 in large part by customer growth. While these investments are necessary and
18 significant, their effect on the Company's overall financial status is not as
19 great as investments in generation.

1 **OTHER O&M AND SIMILAR ITEMS**

2

3 **Q. WHAT ARE SOME OF THE SIGNIFICANT O&M COST**
4 **COMPONENTS UNDERLYING THE PRESENT RATE REQUEST?**

5 **A.** In my opinion, among the most significant O&M components in
6 addition to general inflation in the economy have been the increases in the
7 Company's property taxes. Mitigating these increases have been fee in lieu
8 of taxes arrangements for the Jasper and Urquhart Plants, and although not an
9 O&M cost, the refinancing of debt to reduce interest costs.

10 **Q. PLEASE DISCUSS THE PROPERTY TAX COMPONENT OF O&M**
11 **EXPENSE.**

12 **A.** Given the value of its fixed assets, and the high assessment ratios that
13 apply to investor owned utility assets, each year SCE&G has to pay one of
14 the largest property tax bills of any taxpayer in South Carolina. In the face of
15 increasing financial pressures, local governments in South Carolina have
16 increased property tax rates significantly in recent years. Over the last two
17 years, not counting fee in lieu of taxes arrangements, the millage rates
18 applicable to the Company's facilities have increased by approximately 13%.
19 When compounded with increased investment in taxable assets by the
20 Company, the result is a property tax bill for the Company that has increased
21 from \$77.4 million in 2001 to \$96.2 million in 2003. This represents an

1 \$18.8 million increase or 24%. This increase does not include the property
2 taxes associated with the Jasper Generating Plant.

3 **Q. WHAT HAS THE COMPANY DONE IN RESPONSE TO RISING**
4 **PROPERTY TAXES?**

5 **A.** The Company has successfully negotiated fee in lieu of taxes
6 arrangements for the Jasper and Urquhart Generating Plants. These
7 arrangements have resulted in an approximate two-thirds reduction for the
8 Jasper Plant in what the property tax bill otherwise would have been and an
9 approximate one-half reduction for the Urquhart Plant.

10 **Q. PLEASE DISCUSS THE EFFECT OF DEBT REFINANCING ON THE**
11 **COMPANY'S INTEREST EXPENSES.**

12 **A.** The Company has also reduced its revenue requirements substantially
13 by taking advantage of the historically low interest rates during recent years.
14 During 2003, the Company refinanced \$336 million of its outstanding debt,
15 reducing annual interest cost by \$7.3 million per year as measured for
16 calendar year 2004, or a total of \$153 million had the original issuances
17 remained until maturity. These savings constitute a direct reduction in
18 revenue requirements for the Company.

19
20 **THE DAM REMEDIATION PROJECT AND SYNFUEL**
21 **TAX CREDITS**
22

1
2 **Q. PLEASE DISCUSS THE COMPANY’S PROPOSAL CONCERNING**
3 **THE CAPITAL COSTS RELATED TO THE SALUDA DAM.**

4 **A.** The FERC ordered a major remediation project for Saluda Dam to be
5 implemented in the 2002 to 2005 time period (the “Remediation Project”). In
6 Docket No. 2002-223-E, the Company asked the Commission not to include in
7 rates the construction costs related to the Remediation Project. Instead, it asked
8 the Commission to hold open the question of how the Remediation Project
9 investments would be recovered.

10 The Company is now proposing that the Commission authorize
11 holding the investment in the Remediation Project outside of rate base and
12 offsetting its after-tax construction cost with certain federal income tax
13 credits, generated by the Company’s involvement in partnerships that produce
14 synthetic fuel consumed on its system, net of the operating losses incurred by
15 those partnerships. Our analysis indicates that this approach, barring
16 substantial changes in the laws related to these credits or operational
17 constraints, will allow the entire cost of the Remediation Project to be offset.
18 This will save customers an estimated \$35 million annually had the
19 Remediation Project been placed into rates using the cost of capital set forth
20 in the Application. Under current assumptions, we will not collect revenues
21 nor earn any return from customers on this investment.

1 **Q. PLEASE EXPLAIN THESE SYNTHETIC FUEL TAX CREDITS.**

2 **A.** SCE&G participates in certain partnerships which produce synthetic
3 fuel and, as a result, qualify for tax credits authorized under Section 29 of the
4 Internal Revenue Code of 1986. The Company realizes tax credits in
5 proportion to its ownership interest in the partnerships. The opportunity to earn
6 these credits expires at the end of tax year 2007.

7 The partnerships mentioned above and the benefits they generate are
8 an investment by SCE&G and are not a part of its electric utility operations.
9 However, the Company is proposing to use the value of the credits related to
10 fuel used on its system, net of partnership losses, as an offset to the capital
11 costs of the Remediation Project. This is consistent with the treatment of the
12 credits that the Company requested, and the Commission granted, in the
13 accounting order related to those credits dated June 21, 2000, stating the credits
14 should be applied “to offset the capital costs of projects required to comply
15 with legislative or regulatory actions.”

16 **Q. HOW WOULD THIS PROPOSAL WORK?**

17 **A.** The Company is requesting that the Commission allow the Company
18 to hold the Remediation Project costs outside of rate base in a special account
19 (the “Remediation Project Account”). The Company would then be allowed
20 to book financial depreciation against that account equal to the amount of the
21 pre-tax value of the net synthetic fuel tax credits available during any given

1 period. This depreciation would reduce the balance of the account by the
2 amount of the tax credits available. At the same time, the Company would
3 recognize the tax credits in income for financial reporting purposes, as a
4 reduction to tax expense, thus offsetting the after-tax impact of the expense
5 related to the recognition of depreciation.

6 Because the construction costs of the project will be substantially
7 incurred prior to the generation of most of the tax credits, the Company
8 proposes that it book carrying costs to outstanding amounts in the
9 Remediation Project Account beginning in 2005.

10 Our current analysis indicates that under this plan the entire balance in
11 the Remediation Project Account can be eliminated without any of the
12 depreciation or carrying costs being recovered through rates.

13 **Q. PLEASE OUTLINE HOW THIS PROPOSAL WOULD WORK STEP**
14 **BY STEP.**

15 **A.** The steps involved are as follows:

- 16 • A Remediation Project Account would be established outside of rate
17 base where all Remediation Project costs would be accumulated.
- 18 • In January 2005, the Company would recognize depreciation against
19 the Remediation Project in an amount equal to the pre-tax value of the
20 balance of all synthetic fuel tax credits accrued as of that date.
- 21 • The Company would offset that after-tax depreciation expense by

crediting net synthetic fuel tax credits to income on that date by recognizing a reduction in income tax expense.

- Similarly, as additional net synthetic fuel tax credits are generated in each quarter that follows, an amount of depreciation equal to the pre-tax value of those newly generated credits would be recognized, and corresponding credits would be booked to income.
- Synthetic fuel tax credits would be matched to depreciation against the Remediation Project Account on a quarterly basis until the net balance in this account is zero, assuming sufficient credits are available.
- AFUDC would continue to be recorded through December 31, 2004. After January 1, 2005 the outstanding balance in the Remediation Project Account would accrue carrying costs at the Company's weighted average cost of capital rate as set in this proceeding. For purposes of computing on-going carrying costs, the net present value of the cash benefit related to the future tax depreciation of the Remediation Project assets would be offset against the Remediation Project Account balance on January 1, 2005, thereby reducing carrying costs.

Q. WHAT ARE THE RISKS INVOLVED IN THIS PLAN?

A. The amount or availability of the tax credits is subject to change or

1 disallowance based on audits by the Internal Revenue Service or future
2 amendments to the Federal tax code. In addition, operational problems could
3 limit the ability of the partnerships to produce synthetic fuel in the quantities
4 anticipated. These are the principal risks we envision to the plan but there
5 may be other risks which the company cannot anticipate at this time.

6 **Q. HOW DOES THE COMPANY PROPOSE TO DEAL WITH THESE**
7 **RISKS FROM A REGULATORY STANDPOINT?**

8 **A.** The Company proposes to monitor the implementation of the plan. If
9 risks materialize that would prevent successful implementation of the plan,
10 then the Company would return to the Commission and propose corrective
11 action at that time. At this time, the Company fully expects that the plan will
12 work as envisioned to fully offset the cost of the project without the
13 customers bearing any of the related capital costs.

14 **Q. WHAT DOES THE COMPANY NEED FOR THE COMMISSION TO**
15 **DO IN ITS ORDER TO PUT THIS PROPOSAL IN EFFECT?**

16 **A.** The Company asks that in issuing the order in this case, the
17 Commission approve accounting treatment allowing the Company to record
18 financial depreciation of the Remediation Project in an amount equal to the
19 pre-tax value of available tax credits associated with the fuel consumed on its
20 system and to offset the impact of the depreciation and recover project
21 expenditures by booking to income the corresponding value of such tax

1 credits. The Company also requests that the order allow it to recognize the
2 Remediation Project expenditures as a regulatory asset and record carrying
3 costs, beginning in the first quarter of 2005, on the balance in Remediation
4 Project costs not yet recovered through the application of these synthetic fuel
5 tax credits or through consideration of the tax benefits of depreciation to the
6 extent that such credits are available. The Company requests that the order
7 state that this regulatory asset would be recovered through the application of
8 synthetic fuel tax credits assuming sufficient credits are available. The
9 Company further requests that the order state that carrying costs be computed
10 based on the overall rate of return approved by the Commission in this
11 proceeding.

12 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

13 **A.** Yes, it does.